

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

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Date 12/4/91

Person to Contact: [REDACTED]

Surname [REDACTED]

Telephone Number: [REDACTED]

Refer Reply to: [REDACTED]

Date:

SEP 30 1991

Employer Identification Number: [REDACTED]

Key District: [REDACTED]

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax as an organization described in section 501(c)(3) of the Internal Revenue Code. For the reasons stated below, we conclude that you do not qualify for tax exemption under this section.

You were incorporated on [REDACTED], under the General Not For Profit Corporation Law of [REDACTED]. Your Form 1023, Application for Recognition of Exemption, however, was not filed until [REDACTED].

Your articles of incorporation, as amended, state that you were organized to initiate and manage pooled equity investment in low and moderate income housing which qualifies for tax credit under sections 42 and/or 48 of the Code, within the City of [REDACTED] and neighboring counties (the "Project Area"), by forming general partnerships (hereinafter "Investor Partnerships") with investors, serving as managing partner therein, and investing on behalf of such Investor Partnerships as limited partners in limited partnerships for the rehabilitation, construction, ownership, rental management, and sale or other disposition of such housing.

You state that you were organized to stimulate the development of low and moderate income housing through (a) oversight of a multi-tiered structure which serves as a vehicle to raise substantial equity funding for developers involved in the construction and rehabilitation of low and moderate income housing within the Project Area, and (b) the provision of significant technical assistance to these developers, much of which involves the financial structuring of the projects taken.

████████████████████

Basically, you solicit monies from for-profit corporations. You then invest the monies on behalf of the for-profit corporations into various unspecified limited partnerships that build low and moderate income housing designed to meet the requirements for section 42 low income housing tax credits. You then pass the tax credits back to the for-profit corporations. In substance, you're an investment vehicle which distributes low income housing tax credits.

Your financial support consists of capital contribution fees and administrative fees both of which represent consideration for the various services you provide to both investor-corporations and the limited partnerships in which you act as managing partner.

Section 501(c) (3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable and educational purposes.

Section 1.501(c) (3)-1(a) (1) of the Income Tax Regulations provides that in order to be exempt under section 501(c) (3) of the Code, an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c) (3)-1(c) (1) of the regulations provides that an organization will not be regarded as operated exclusively for exempt purposes if more than an insubstantial part of its activities is not in furtherance of exempt purposes.

Section 1.501(c) (3)-1(d) (2) of the regulations defines the term "charitable" as including the relief of the poor and distressed or of the underprivileged, and the promotion of social welfare by organizations designed to lessen neighborhood tensions, to eliminate prejudice and discrimination, or to combat community deterioration.

Section 1.501(c) (3)-1(e) (1) of the regulations provides that an organization may meet the requirements of section 501(c) (3) of the Code although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business, as defined in section 513.

Section 513(a) of the Code defines the term "unrelated trade or business" as any trade or business the conduct of which is not

substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501(c)(3).

Rev. Rul. 70-585, 1970-2 C.B. 115, holds that certain nonprofit housing organizations created to aid low and moderate income families by lessening neighborhood tensions, eliminating prejudice and discrimination, and combatting community deterioration may qualify for exemption under section 501(c)(3) of the Code. Situation 1 of this ruling provides that the provision of housing to low income persons is charitable within the meaning of section 501(c)(3).

Rev. Rul. 68-225, 1968-1 C.B. 283, holds that a non-profit organization that provides consulting services for local businesses on matters relating to securing housing for their minority group employees is not engaged in an unrelated trade or business because the services provided contribute importantly to the accomplishment of the organization's exempt purposes and thus are substantially related to the organization's exempt purposes.

In Portland Golf Club v. Commissioner, 110 S.Ct. 2780 (1990), the Supreme Court held that an organization may use losses incurred in an unrelated trade or business to offset investment income only if those sales were motivated by an intent to profit -- that is, an intent to generate receipts in excess of costs. The Supreme Court reemphasized an earlier opinion which stated that "although the statute does not expressly require that a 'trade or business' must be carried on with an intent to profit, this Court has ruled that a taxpayer's activities fall within the scope of section 162 of the Code only if an intent to profit has been shown."

In National Water Well Association, Inc. v. Commissioner, 92 T.C. 75 (1989), the Tax Court stated that it has consistently held that the profit motive test under section 162 of the Code applies to the question of whether an activity constitutes a trade or business for purposes of the tax on unrelated business income. Under the profit motive test, if an organization's motive or intent for engaging in an activity is the production of income, then that activity constitutes a trade or business.

The Supreme Court of the United States, in Better Business Bureau v. United States, 326 U.S. 279 (1945), held that if the nonexempt activities of the organization are more than incidental or insubstantial, the organization is not entitled to exemption

under section 501(c)(3) of the Code, regardless of the number or importance of its exempt purposes.

You do not fall within that aspect of charity which is concerned with providing relief to the poor or distressed or the underprivileged, because you are not directly engaged in activities designed to ameliorate the conditions of such persons. Instead, you are primarily operated as an investment vehicle for for-profit corporations seeking low income housing tax credits. Although your activities may increase the available housing for some individuals who are poor and distressed, that result is incidental to your primary purpose of serving as a vehicle for the distribution of tax credits.

Even assuming, arguendo, that you are engaged in the production of low and moderate income housing, your selection criteria for recipients fails to define a charitable class within the meaning of section 501(c)(3) of the Code and the regulations thereunder. Housing projects that qualify for low income housing tax credits do not necessarily define a charitable group of recipients for purposes of section 501(c)(3). The focus is on whether the activities undertaken by an organization benefit a charitable class within the meaning of section 1.501(c)(3)-1(d)(2) of the regulations, e.g. the "poor" or those lacking the basic necessities of life. Although a portion of the housing projects in which you direct your client's funds may include persons who are "poor," the minimum requirements for section 42 tax credits (wherein either 20% of the available units must be made available to persons earning 50% of the area's median income or 40% of the available units be made available to persons earning 60% of the area's median income) are insufficient to confer charitable status upon such housing projects. As such, you are providing housing to persons who do not necessarily constitute a charitable class. Since you are not engaged in activities designed to ameliorate the conditions of the poor and distressed, you are distinguishable from the organization in Situation 1 of Rev. Rul. 70-585, supra, and may not be recognized as exempt under section 501(c)(3).

You are also distinguishable from the organization in Rev. Rul. 68-225, supra. The organization in Rev. Rul. 68-225 conducts charitable and educational programs that foster and promote fair housing in a metropolitan area. In furtherance of those purposes, the organization performs consulting services in an effort to secure housing for minority employees of local businesses, an activity directly related to its charitable purpose of fostering and promoting fair housing. Although your efforts may result in increasing the supply of affordable housing for the poor and distressed in the Project Area, such a result,

if it occurs at all, is an incidental byproduct of the investment services provided by you to the for-profit businesses. As such, you are distinguishable from the organization in Rev. Rul. 68-225, in that your investment services are not directly related to providing a charitable service or promoting a charitable activity.

Since your activities serve a substantial nonexempt purpose, the provision of investment services for for-profit organizations, you may not be recognized as exempt under section 501(c)(3) of the Code. Since more than an insubstantial part of your activities are not in furtherance of exempt purposes, you fail the operational test of section 1.501(c)(3)-1(c)(1) of the regulations and, in accord with section 1.501(c)(3)-1(a)(1) may not be recognized as exempt under section 501(c)(3).

Like the organization in Portland Golf Club, supra, you are engaged in an activity, the provision of investment services, with an intent to derive an economic profit. Since your investment activities are conducted with a profit motive, you are engaged in a "trade or business" within the meaning of section 513(a). See National Water Well Association, Inc. and Portland Golf Club, both cited supra.

Your primary activity is to serve as an investment vehicle for the distribution of tax credits to for-profit entities for a fee. Therefore, even assuming that some of your activities do incidentally further charitable purposes, you, nonetheless, are primarily engaged in the conduct of unrelated trade or business within the meaning of section 513(a) of the Code. As such, section 1.501(c)(3)-1(e)(1) of the regulations provides that you may not be recognized as exempt under section 501(c)(3). In addition, since your activities serve a substantial nonexempt purpose, Better Business Bureau v. United States, supra, provides that you may not be recognized as exempt under section 501(c)(3) of the Code.

Finally, we note that you filed your Form 1023 beyond the time period allowed by the Code and regulations. In your Form 1023, you agreed that in the event you are found to be exempt under section 501(c)(3), your recognition of exemption would be prospective from the date of your filing.

Based on the foregoing, we hold that you do not qualify for exemption from federal income tax as an organization described in section 501(c)(3) of the Code. Therefore, contributions to you are not deductible under section 170 of the Code. You are required to file federal income tax returns on Form 1120.

[REDACTED]

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement must be submitted within 30 days from the date of this letter and must be signed by one of your officers. When sending a protest or other correspondence with respect to this case, you will expedite its receipt by placing the following symbols on the envelope: [REDACTED]. These symbols do not refer to your case, but rather to its location.

You also have the right to a conference in this office after your protest statement is submitted. If you want a conference, you must request it when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements.

If you do not protest this proposed ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgment or decree under this section shall not be issued in any proceedings unless the United States Tax Court, the United States Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to the District Director, Chicago, Illinois, which is your key district for exempt organization matters. Thereafter, any questions about your federal income tax status should be addressed to your key District Director. The appropriate State Officials will be notified of this action in accordance with section 6104(c) of the Code.

Sincerely yours,

(signed) [REDACTED]

[REDACTED]
Chief, Exempt Organizations
Rulings Branch 1

cc: [REDACTED]

cc: [REDACTED]

cc: [REDACTED]

STATE
OFFICIALS